

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
CURRENCY OVERLAY PROGRAM**

**November 13, 2006**

*This Policy is effective immediately upon adoption and supersedes all previous currency overlay program policies. This Policy incorporates the Tactical Management Portfolio, the Currency Overlay Portfolio - Externally Managed, the Passive Currency Overlay Portfolio - Internally Managed, and the Active Currency Overlay Portfolio - Internally Managed.*

**I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the [Currency Overlay Program](#) ("the Program"). There are several components to the Program:

1. the static [hedge](#) ratio;
2. tactical management of the hedge ratio; and
3. implementation of the program through:
  - a) Currency Overlay Portfolio- Externally Managed
  - b) Passive Currency Overlay Portfolio- Internally Managed; and,
  - c) Active Currency Overlay Portfolio- Internally Managed.

There are several sections of this policy which reflect the components of the Program. This first section is intended as the explanation of the Program as a whole. Details of the tactical management of the hedge ratio are outlined in Attachment 1. Details of the Externally Managed Portfolio are in Attachment 2, The Passive Internally Managed Portfolio are in Attachment 3, and the Active Portfolio- Internally Managed are in Attachment 4.

The static ratio has been determined to be 25% of the currency weights of the [Developed Markets](#) portion of the International Equity Program by the System's Investment Committee ("the Investment Committee").

This Policy defines the tactical management of the hedge ratio and the implementation of the program through Externally and Internally managed Passive and Active approaches.

The design of this Policy ensures that the currency exposure of the California Public Employees' Retirement System's ("the System") international equity program is managed with prudence and care. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of international equity and other international investments.

This Policy will be the controlling document for Currency Overlay – Tactical Management Portfolio (Attachment 1), Currency Overlay Portfolio Externally Managed (Attachment 2), Passive Currency Overlay Portfolio - Internally Managed (Attachment 3), and the Active Currency Overlay Portfolio - Internally Managed (Attachment 4).

The Program may include other portfolios or other currency functions as they relate to the System without prior Investment Committee approval. Hedging activity in other asset classes shall be determined by the Senior Investment Officer (SIO) in the respective asset class, and implemented by the internal currency team.

## **II. STRATEGIC OBJECTIVE**

- A. Lower return volatility of the International Equity Program is the primary objective of the Program;
- B. Return is the secondary consideration;
- C. The Program should be able to hedge [currency risk](#) for other assets beyond International Equity;
- D. Protect the System's International Equity Program from incurring large currency losses during the near term (one-to-three years), at reasonable cost, with effective cash flow management in the settlement of [derivative](#) positions; and
- E. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

## **III. RESPONSIBILITIES AND DELEGATIONS**

- A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment

Committee delegates the responsibility for administering the Program through the Delegation of Authority (Delegation Nos. 89-13 and 06-03-INV).

- B. The **System's Investment Staff** ("the Staff") duties include, but are not limited to, the following:
1. Developing and recommending the Policy to the Investment Committee;
  2. Developing and maintaining procedures manual, subject to periodic reviews and updates, and outlining Staff operational procedures used in implementing this Policy;
  3. Implementing and adhering to the Policy;
  4. Recommending changes to the Program, its guidelines or management practices, which are pertinent to ensure the continual achievement of the Program's objective;
  5. Report quarterly all violations of the Policy to the Chief Investment Officer and at the next Investment Committee meeting with explanations.
  6. Communicating with other Staff, as needed, regarding investment strategy and investment results;
  7. Coordinating with the portfolio manager of the underlying equity portfolio and the System's master custodial bank to ensure that a clear understanding of the currency exposures of the underlying portfolio(s) exists with which the Program is overlayed;
  8. Cooperating fully with other System Staff, the System's [custodian](#), and [General Pension Consultant](#) on requests for information; and
  9. Specific to attachment # 2, recommending action concerning outside money management firm(s) ("Managers") retained under contract to implement the Program in accordance with the External Investment Manager and Currency Overlay Manager Monitoring Policy. Duties may include making recommendations with respect to changes in the Manager's contractual guidelines or regarding any other aspect the Staff considers pertinent.

- C. The **General Pension Consultant** (the "General Pension Consultant") is responsible for monitoring and evaluating the Program's performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.
- D. Each **External Manager** is responsible for all aspects of portfolio management as set forth in its contract with the System and shall fulfill the following duties:
  - 1. Communicate with the Staff, as needed, regarding investment strategy and results. The Manager shall monitor, analyze, and evaluate performance relative to the agreed-upon benchmark;
  - 2. Coordinate with the System's master custodial bank to ensure that there is a clear understanding of the currency exposures of the underlying portfolio(s) through which overlay of the Program exists; and
  - 3. Cooperate fully with the System's Staff, Custodian, and General Pension Consultant on requests for information.

#### **IV. PERFORMANCE OBJECTIVE**

The primary concern shall be risk control with a secondary objective of return. The benchmark is the fully hedged currency return of the developed markets portion of the Passive International Equity Index Fund.

There are four separate parts to the Program and the performance objectives are outlined below:

- A. The Tactical Management Portfolio, with the goal of adding return. Staff will incrementally add value relative to the static 25% hedge ratio of International Equity (details are in Attachment 1).
- B. The Currency Overlay Portfolio- [Externally Managed](#), with the primary objective of risk reduction and secondary consideration of return, shall achieve results specific to the prevailing currency market environment as follows:
  - 1. In appreciating foreign currency environments, the Manager shall seek to capture approximately 60% of currency gains; and

2. In depreciating foreign currency environments, the Manager shall seek to limit losses to no more than 3% below the fully hedged benchmark.
3. In flat or trend less environments, the Manager shall approximate the benchmark results.

(Details are in Attachment 2).

- C. Passive Currency Overlay Portfolio- Internally Managed, with the primary objective of risk reduction: results shall approximate that of the benchmark, within +/- 50 basis points in a 12 month period

(Details are in Attachment 3).

- D. Active Currency Overlay Portfolio- Internally Managed with the primary objective of adding return.

1. Target information ratio goals are from 0.3 to 0.75.
2. Target losses to no more than 3% below the fully hedged benchmark.

(Details are in Attachment 4).

## **V. BENCHMARK**

- A. Tactical Management Program Benchmark will be the static 25% hedge of the currency weights of the Developed International Equity Exposure.
- B. The Currency Overlay Portfolio- Externally Managed Benchmark shall be a percentage of the currency weights of the Developed Markets portion of the Passive International Equity Program, fully hedged.
- C. The Passive Currency Overlay Portfolio- Internally Managed Benchmark shall be a percentage of the currency weights of the Developed Markets portion of the Passive International Equity Program, fully hedged.
- D. The Active Currency Overlay Portfolio- Internally Managed Benchmark shall be a percentage of the currency weights of the Developed Markets portion of the Passive International Equity Program, fully hedged.

**VI. GENERAL**

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on market-value basis, as recorded by the System's custodian.

**VII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Fixed Income Glossary of Terms which is included in the System's Master Glossary of Terms.

**Currency Overlay – Externally Managed**

Approved by the Policy Subcommittee:	August 11, 1999
Adopted by the Investment Committee:	October 18, 1999
Attached to the Currency Overlay Program:	August 15, 2005

**Passive Currency Overlay Program – Internally Managed**

Approved by the Policy Subcommittee:	March 16, 2001
Adopted by the Investment Committee:	April 16, 2001
Attached to the Currency Overlay Program:	August 15, 2005

**Currency Overlay Program – Overarching Policy with Portfolio Attachments**

Approved by the Policy Subcommittee:	June 10, 2005
Adopted by the Investment Committee:	August 15, 2005
Revised by the Policy Subcommittee:	October 16, 2006
Adopted by the Investment Committee:	November 13, 2006

**Attachment 1****TACTICAL MANAGEMENT PORTFOLIO****I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Tactical Management Portfolio ("the Portfolio"). The design of this Policy ensures that the currency exposure of the California Public Employees' Retirement System's ("the System") international equity program is managed with prudence and care. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of international equity.

**II. STRATEGIC OBJECTIVES**

The Program shall be managed to accomplish the following:

- A. Reduce the System's International Equity Program's risk due to currency volatility; and
- B. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

**III. PERFORMANCE OBJECTIVE**

The objective is to add value over an economic cycle (approximately 3-8 years) over what a static 25% hedge would have produced, for the entire Developed Markets portion of the International Equity assets.

**IV. INVESTMENT APPROACHES AND PARAMETERS****A. Approach**

A five member staff committee (staff committee), consisting of the Chief Investment Officer (CIO), Senior Investment Officer Fixed Income (SIO), Senior Portfolio Manager Fixed Income and the Portfolio Manager of Currency and Portfolio Manager International Research will seek to identify macro trends based on fundamental factors that have a high probability of success. Studies indicate that observable economic factors known to affect currency markets include, but are not limited to interest rate differentials, trade deficits, GDP growth, inflation, monetary policy, fiscal policy and productivity. These economic factors work slowly over time; therefore the staff committee time focus will be over a

cycle, typically 3 to 8 years. A shorter term approach does not always allow sufficient time for economic fundamentals to work their way through to be reflected in currency values. Therefore, it can be difficult for external managers to focus on long term inputs when those inputs can be overwhelmed by short term issues. The staff committee will seek to capitalize on the System's long term investment nature by focusing on the cyclical nature of developed currencies. The CIO would have veto power over any decision.

The variation of the hedge ratio shall be determined by considering the following:

1. Economic fundamentals which work over time;
2. Costs related to the hedge, particularly the cost of carry; and
3. Moves in the hedge ratio would only be made when convincing evidence exists for long term trends. Return on such decisions should be measured over a cycle, which is calculated in years. It is anticipated that there will be infrequent changes.

### **Parameters**

The static hedge ratio is 25% of the currency weights of the Developed Markets portion of the International Equity assets. The staff committee may vary the hedge ratio +/- 5% (implying a range of 20 to 30% for the hedge ratio.) The staff committee will meet every three to six months.

## **V. BENCHMARK**

The benchmark for the program shall be the fully hedged currency return on a static 25% hedge ratio, and shall be a function of the International Equity Program.

## **VI. GENERAL**

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System.

## **VII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Fixed Income Glossary of Terms which is included in the System's Master Glossary of Terms.



**Attachment 2****CURRENCY OVERLAY PORTFOLIO- EXTERNALLY MANAGED****I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Currency Overlay Portfolio- Externally Managed ("the Portfolio"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing opportunities as they may occur.

**II. STRATEGIC OBJECTIVES**

Lowering the return volatility of the International Equity Program is the strategic objective of the Program. This shall be accomplished through the partial hedging of the currency exposure in the developed markets portion of the System's Passive International Equity Index Fund. This partial hedge is currently targeted at 25%.

The Program shall employ techniques to balance risk reduction with hedging cost and cash flow management. Therefore, it is expected that only under rare circumstances shall the program result in a 100% hedged (zero currency volatility) exposure.

The Program shall be managed to accomplish the following:

- A. Protect the System's International Equity Program from incurring large currency losses during the near term (one-to-three years), at reasonable cost, with effective cash flow management in the settlement of derivative positions; and
- B. Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law.

### **III. PERFORMANCE OBJECTIVES**

The Currency Overlay Portfolio - Externally Managed controls risk rather than generate return. The Program shall achieve results specific to the prevailing currency market environment as follows:

- A. In appreciating foreign currency environments, the Portfolio shall seek to capture approximately sixty (60) percent of currency gains;
- B. In depreciating foreign currency environments, the Portfolio shall seek to limit losses to no more than three (3) percent below the fully hedged benchmark; and
- C. In flat or trendless environments, the Portfolio shall approximate the benchmark results.

### **IV. INVESTMENT APPROACHES AND PARAMETERS**

#### **A. Approach**

- 1. The risk and return characteristics of the international equity assets subject to the Currency Overlay Program (hedged assets) shall differ significantly from the portion of the international equity assets outside the program. Therefore, different strategic risk and return assumptions shall be developed for the Program for asset allocation planning purposes, in accordance with the Strategic Asset Allocation Policy, incorporated herein by reference. The specific allocation of assets subject to the Currency Overlay Program shall be determined by the financial analysis prescribed under the Strategic Asset Allocation Policy and shall vary within ranges prescribed therein.
- 2. Execution of the Currency Overlay Program shall occur through a portfolio(s)' investments in developed markets where currency market exposure is relatively predictable. Portfolios most suitable are passive index funds or semi-active approaches.
- 3. The Program shall be implemented through the retention of an external manager(s). The external manager selection shall occur in accordance with Section IV.B. of this Policy.
- 4. The viability of the program shall be reviewed continually, with a formal review at least every five years.

**B. External Manager Selection**

1. The System shall retain Manager(s) recognized for their expertise in Currency Overlay Programs with a multiple-manager structure and in approved derivative management. The Manager(s) shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.
2. Manager(s) shall be selected in accordance with the System's Contract and Procurement Policy.

**C. Investment Parameters**

1. The Manager(s) shall operate under a set of specific guidelines outlining their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted [securities](#) and procedures, and performance objectives representative of their strategic role within the Program and the investment risk incurred.
2. Implementation of this Program shall comply at all times with the System's investment policies including, but not limited to, the following criteria:
  - a. Statement of Policy for Derivatives - External Managers;
  - b. External Investment Manager and Currency Overlay Manager Monitoring Policy; and
  - c. Manager-Specific Investment Management Guidelines.
3. Manager(s) shall execute currency transactions in the forward currency markets or in related currency derivative instruments over the long currency positions of the underlying portfolio(s) of assets assigned. At no time shall Manager(s) assume any foreign equity positions in their own accounts.
4. The Manager(s) shall monitor their currency positions to avoid [leverage](#) regarding the net currency exposure of the underlying portfolio through a net long position in foreign currency [forwards](#) or a net short position once the hedge and the underlying portfolio are combined. Currency positions taken shall constitute a designated hedge of the actual international assets identified in the underlying portfolio.

**V. BENCHMARK**

The Currency Overlay Portfolio- Externally Managed Benchmark shall be a percentage of the currency weights of the Developed Markets portion of the Passive International Equity Program, fully hedged.

**VI. DERIVATIVES AND LEVERAGE POLICY****A. Forwards, Options, and Swaps.**

1. Leverage shall be avoided as cited in Section IV. C. 4
2. The Portfolio may buy or sell non-exchanged traded derivatives, which includes [over-the-counter](#) forwards, [options](#), and [swaps](#).
3. Bona fide hedging of foreign currency exposure is the only acceptable strategy.

**B. Restrictions and Prohibitions**

Any action or transaction not expressly permitted by this Policy is prohibited unless presented to and approved by the Investment Committee.

**C. Counterparty Exposure for Forwards, Options, and Swaps**

1. The counterparty exposure shall be integrated and managed with existing System counterparty exposures.
2. Transactions shall be executed with counterparties [rated](#) A- ([Standard & Poor's](#)), or A- (Fitch) or A3 ([Moody's](#)) or higher by at least 1 of 3 rating agencies.

**VII. GENERAL**

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on market-value basis, as recorded by the System's custodian.

**VIII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Fixed Income Glossary of Terms which is included in the System's Master Glossary of Terms.

**Attachment 3****PASSIVE CURRENCY OVERLAY PORTFOLIO- INTERNALLY MANAGED****I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Passive Currency Overlay Portfolio - Internally Managed ("the Portfolio"). The design of this Policy ensures that the currency exposure of the California Public Employees' Retirement System's ("the System") international equity program is managed with prudence and care. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of international equity.

**II. STRATEGIC OBJECTIVES**

The Portfolio shall be managed to accomplish the following:

- A. Reduce the System's International Equity Program's risk due to currency volatility; and
- B. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

**III. PERFORMANCE OBJECTIVE**

The Portfolio shall control risk rather than generate return. The Portfolio shall reduce risk versus the volatility of the underlying equity portfolio. Results shall approximate that of the benchmark, within +/- 50 basis points in a 12-month period. The benchmark is the fully hedged currency return of the developed markets portion of the Passive International Equity Index Fund.

**IV. INVESTMENT APPROACHES AND PARAMETERS****A. Investment Approaches**

- 1. The portfolio will be passively managed and will target the developed markets portion of the passive international equity index fund.

**B. Specific Parameters**

- 1. The allocation to the Portfolio shall represent a portion of the Total Currency Overlay Program. The percent of assets

allocated to the Program shall be determined by considering the following:

- a. Cost versus expected attained risk reduction versus other alternatives; and
- b. Optimal impact to the overall Currency Management Program.

The Staff shall conduct the appropriate analyses to support such a recommendation.

2. The below table specifies allowable hedge ratio ranges:

#### Permissible Passively Managed Hedge Ratio Ranges

Benchmark	Hedge Ratio Range
100%	95% - 105%

3. The Portfolio shall track a fully hedged benchmark that reflects the specific currencies of the underlying equity portfolio as specified in Section IV. B. 2. of this Policy.
4. The Portfolio shall execute currency transactions in the forward currency markets or in related currency derivative instruments over the long currency positions of the underlying portfolio(s) of assets assigned to it.
5. The Portfolio shall monitor its currency positions to avoid leverage. Currency positions taken shall constitute a designated hedge of the actual international assets identified in the underlying portfolio.
6. The System shall allow wider tracking error should there be deliberate decisions to redefine the developed markets portion of the externally-managed passive international equity index fund. This would include but not be restricted to the entry/exit of individual countries or the major rebalancing of country weightings within the Index.

7. Implementation of this Portfolio shall comply at all times with the System's investment policies including, but not limited to, the following:
  - a. Statement of Derivatives Investment Policy; and
  - b. Internal Program Operation Procedures Manual

## **V. BENCHMARK**

The Passive Currency Overlay Portfolio- Internally Managed Benchmark shall be a percentage of the currency weights of the Developed Markets portion of the Passive International Equity Program, fully hedged.

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System.

## **VI. DERIVATIVES AND LEVERAGE POLICY**

### **A. Forwards, Options, and Swaps**

1. Leverage shall be avoided as cited in Section V. B. 5.
2. The Portfolio may buy or sell non-exchanged traded derivatives, which includes over-the-counter forwards, options, and swaps.
3. Bona fide hedging of foreign currency exposure is the only acceptable strategy.

### **B. Restrictions and Prohibitions**

Any action or transaction not expressly permitted by this Policy is prohibited unless presented to and approved by the Investment Committee.

### **C. Counterparty Exposure for Forwards, Options, and Swaps**

1. The counterparty exposure shall be integrated and managed with existing System counterparty exposures.
2. Transactions shall be executed with counterparties rated A- (Standard & Poor's), or A- (Fitch) or A3 (Moody's) or higher by at least 1 of 3 rating agencies.

**VII. GENERAL**

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System.

**VIII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Fixed Income Glossary of Terms which is included in the System's Master Glossary of Terms.



**Attachment 4****ACTIVE CURRENCY OVERLAY PORTFOLIO - INTERNALLY MANAGED****I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Active Currency Overlay Portfolio- Internally Managed ("the Portfolio"). The design of this Policy ensures that the currency exposure of the California Public Employees' Retirement System's ("the System") international equity program is managed with prudence and care. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of international equity.

**II. STRATEGIC OBJECTIVES**

The Portfolio shall be managed to accomplish the following:

- A. Enhance the Currency Overlay Program's total return;
- B. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

**III. PERFORMANCE OBJECTIVE**

Exceed the currency return of the developed markets portion of the International Equity Program, fully hedged.

**IV. INVESTMENT APPROACHES AND PARAMETERS****A. Investment Approach**

The objective is to add incremental currency return by implementing various active strategies. Active management styles implemented in the program include:

1. Fundamental. Over the long run, currency prices deviate from fair value based on cyclical behavior of economies. Fundamental strategies attempt to identify over/undervalued currencies by using various economic indicators such as inflation, growth or trade data.

2. Technical. Technical strategies attempt to identify markets where prices are moving in clear and predictable trends. Price trends and stress points in currency markets can be identified and exploited using a number of indicators such as moving averages, chart patterns, support and resistance indicators and flow models.
3. Interest Rate (Carry). Carry strategies seek to anticipate currency movements driven by differences and changes in national interest rates. Overweighting currencies with high yields and underweighting currencies with lower yield tends to produce excess returns.
4. Volatility. Volatility strategies are used to exploit mispricing in currency options based on varying interpretations of changes in spot prices.

**B. Parameters**

1. [Shortfall risk](#) shall be controlled by limiting the negative return to 300 basis points for a rolling 12 month period. A violation of this threshold shall require a review by the SIO of Fixed Income to determine if a partial or full liquidation of positions is warranted.
2. Benchmark risk addresses whether the developed markets portion of the Passive International Equity Index Portfolio is the appropriate reference point.
3. Currency Risk is the risk of hedging currency differently than the index. The following table specifies the allowable ranges. The table differentiates between major and minor currency pairs and specifies allowable ranges within which actual allocations can fluctuate. Allowable ranges for major currency pairs are between +/- 20% of the benchmark weight, while minor currencies can vary between +/- 10% of the benchmark weights. Net portfolio weights must remain between 0% and 200% hedged.

## Country Currency Allowable Ranges

### Major Currency Pairs- Subject to index weights +/- 20%

Currency	Benchmark country weight*	Range
Euro	32%	12% – 52%
UK Sterling	22%	2% – 42%
Japanese Yen	22%	2% – 42%

### Minor Currency Pairs- Subject to index weights +/- 10%

Currency	Benchmark country weight*	Range
Canadian Dollar	6%	-4% - 16%
Swiss Franc	6%	-4% -16%
Australian Dollar	5%	-5% - 15%
Hong Kong Dollar	3%	-7% - 13%
Swedish Krona	2%	-8% -12%
Singapore Dollar	1%	-9% - 11%
Norwegian Krone	1%	-9% - 11%
Danish Krone	1%	-9% - 11%
New Zealand Dollar	0.2%	-10% - 10%

\*Benchmark country weights as of September 2006. Total may not sum to 100% due to rounding.

### Net Portfolio Weight must remain between 0% and 200%.

Index currencies and weights will change over time in line with movements in the underlying passive equity index portfolio.

4. Liquidity risk is the ease with which a specific amount can be sold at or near market prices. Liquidity risk shall be managed in a disciplined manner by maintaining numerous dealing relationships with geographically diverse counterparties.
5. Interest rate risk is the price volatility produced by changes in the overall level of interest rates. Forward currency contracts are a function of domestic relative to foreign country interest rates. This risk is managed by using forward contracts that are within 2 years of the benchmark.

**V. BENCHMARK**

The Active Currency Overlay Portfolio- Internally Managed Benchmark shall be a percentage of the currency weights in the Developed Markets portion of the Passive International Equity Program, fully hedged.

**VI. DERIVATIVES AND LEVERAGE POLICY****A. Forwards, Options, and Swaps**

The Portfolio may buy or sell exchange or non-exchanged traded derivatives, which includes over-the-counter forwards, options, and swaps.

**B. Restrictions and Prohibitions**

Any action or transaction not expressly permitted by this Policy is prohibited unless presented to and approved by the Investment Committee.

**C. Counterparty Exposure for Forwards, Options, and Swaps**

1. The counterparty exposure shall be integrated and managed with existing System counterparty exposures.
2. Transactions shall be executed with counterparties rated A- (Standard & Poor's), or A- (Fitch) or A3 (Moody's) or higher by at least 1 of 3 rating agencies.

**VII. GENERAL**

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System.

**VIII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Fixed Income Glossary of Terms which is included in the System's Master Glossary of Terms.